



Treasury Trends

Bringing currency to the Arizona Taxpayer

David A. Petersen, State Treasurer

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This month's
character trait ---

Persuasiveness:
*Guiding vital truths
around another's
mental roadblocks*

**Both LGIP Pools
continue to
outperform their
benchmarks in
December 2003**

**NCFE Files
Fourth Amended
Bankruptcy Plan**

LGIP Performance

The Board of Investment, in the regular meeting held on January 21, 2004 was informed of the performance of the LGIP and LGIP-Gov pools. Both pools continued to outperform their benchmarks. Balances of the pools also remained relatively stable for the month.

| <i>Yields</i> | LGIP | LGIP Index | Diff | LGIP-GOV | 3 mo. T-Bill | Diff |
|------------------|----------------|-------------------|-------------|-----------------|---------------------|-------------|
| Pool size → | \$2.0 B | | | \$1.6 B | | |
| January | 2.00 | 1.17 | + .83 | 1.11 | 1.18 | - .07 |
| February | 1.48 | 1.11 | + .37 | 1.24 | 1.18 | + .06 |
| March | 1.59 | 1.09 | + .50 | 1.35 | 1.14 | + .21 |
| April | 1.62 | 1.06 | + .56 | 1.18 | 1.14 | + .04 |
| May | 1.73 | 1.03 | + .70 | 1.21 | 1.08 | + .13 |
| June | 1.88 | .99 | + .89 | 1.54 | .93 | + .61 |
| July | 1.58 | .85 | + .73 | 1.44 | .90 | + .54 |
| August | 1.51 | .83 | + .68 | .97 | .96 | + .01 |
| September | 1.48 | .83 | + .65 | .97 | .95 | + .02 |
| October | 1.43 | .83 | + .60 | .97 | .93 | + .04 |
| November | 1.43 | .85 | + .58 | .99 | .94 | + .05 |
| December | 1.44 | .88 | + .56 | .98 | .90 | + .08 |

Nationwide Perspective

In the convoluted world of bankruptcy proceedings, NCFE is holding true to the pattern. On January 15, 2004, NCFE filed its FOURTH reorganization plan. For those interested in reading the plan, downloads are available at www.NCFE.com. Despite the revisions of the bankruptcy plan, the process seems to be progressing in a timely and orderly manner. The Arizona State Treasurer's Office, represented by the Attorney General's Office, is monitoring the process and encouraging all efforts to speed things along, without jeopardizing the interests of the LGIP participants. The faster the plan is approved, the lower the attorney fees. So, we have an interest in accelerating process as much as possible. At this point, there have been no estimates from the bankruptcy estate as to the timing and amount of any recoveries. As usual, if you have questions concerning this issue, please feel free to contact Blaine Vance, Deputy Treasurer, at (602) 542-1448 or email at blainev@treasury.state.az.us

**Treasury-backed
repo increases
yield on short-
term cash**

**Q2 upgrade paves
way for LGIP
on-line**

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Repurchase Basics

Our portfolio reports show various pools in the Treasurer's Office invest in repurchase agreements or "repo". Some ask why these investments are used and how they function. Repurchase agreements are a useful method for investing short-term cash. Traditionally, they are used to invest cash overnight. These overnight investments have a significantly higher yield than money market accounts. Repurchase agreements, as used in the Arizona Treasurer's Office, are basically a short-term purchase and sale of U.S. Treasury securities. We buy Treasury securities one day with a contractual requirement to sell the securities back to the dealer the next day. The difference between the contractual buy price and sell price is the yield or profit to the pools.

Is there risk in these transactions? You decide. When we buy \$1,000,000 in Treasuries, we require the dealer to send us collateral for the transaction of 102% or \$1,020,000 in marketable Treasury securities. In this way, should the dealer "fail" to buy back the securities, as agreed, we own sufficient Treasuries to liquidate and get cash back. Until the collateral is received and verified, we do not release our cash to the dealer. Should the dealer "fail" to deliver adequate collateral, the cash is not released. This is called a "failed repo." While a "fail" on a repo sounds bad, one thing to remember is that the funds of the pools are not at risk, because the cash isn't released until collateral is actually received. The only loss in a "fail" is the difference in interest earned in a money market fund and what would have been earned by the repo. In most cases, the dealers pay us an amount equal to the lost interest due to the "fail." This is called a "good fail."

With all the safeguards in place, treasury-backed repo is a valuable and low-risk method for increasing yield on short-term cash assets.

Q2 Upgrade Completed

January 20, 2004 was an exciting day at the Treasurer's Office. Investment accounting and IT departments announced the successful completion of the Q2 upgrade of the investment accounting system. This is an important milestone because this was the first major hurdle to implementing our LGIP on-line capabilities. Two more hurdles to jump and the LGIP on-line will be a reality. We will be asking for volunteers to "Beta" test the on-line system in the next few months. Once we are sure of on-line security and data accuracy, there will be a universal roll-out to all LGIP members. We appreciate your patience as we go through this major evolution in the services we provide our LGIP participants.

Yield Curve Perspective

| Treasury Yield Curve | | | | |
|----------------------|--------|----------------|-----------------|----------------|
| Term | 27 Jan | 1 Week Earlier | 1 Month Earlier | 1 Year Earlier |
| 3 mo. | .91 | .87 | .87 | 1.16 |
| 6 mo. | .97 | .95 | 1.00 | 1.17 |
| 2 yr. | 1.64 | 1.65 | 1.85 | 1.65 |
| 3 yr. | 2.10 | 2.11 | 2.31 | N/A |
| 5 yr. | 3.05 | 3.04 | 3.23 | 2.90 |
| 10 yr. | 4.07 | 4.06 | 4.24 | 3.96 |
| 30 yr. | 4.94 | 4.92 | 5.05 | 4.88 |